No. 84-95

IN THE
Supreme Court of the United States

OCTOBER TERM, 1984

NATIONAL ASSOCIATION OF
REGULATORY UTILITY COMMISSIONERS,
Petitioner,
v.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA, *et al.*
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF IN OPPOSITION OF RESPONDENTS THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, NORTHWESTERN BELL TELEPHONE COMPANY AND PACIFIC NORTHWEST BELL TELEPHONE COMPANY

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The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company [1] herewith sub-

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[1] The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company are three operating companies divested from AT&T

mit their brief in opposition to the petition for a writ of certiorari filed herein by the National Association of Regulatory Utility Commissioners ("NARUC").

STATEMENT OF THE CASE

Responding to fundamental and dynamic changes in the telecommunications industry—a technological revolution and the break-up of AT&T, which, until January 1, 1984, provided most long-distance and local exchange telephone services on a unified basis—the Federal Communications Commission ("Commission") issued a historic order on February 28, 1983, in which it prescribed, *inter alia*, a new method of cost recovery for that portion of local telephone company plant and equipment allocable to interstate services.[2] This order was preceded by over five years of extensive and intensive study by the Commission, including the solicitation and consideration of the views, proposals and arguments of every facet of the telecommunications industry.[3] The Access Order was followed by two further pronouncements of the Commission which fine-tuned and modified many of the provisions of the original order.[4] In review of the foregoing administrative action, the Court of Appeals for

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under the *Modified Final Judgment* in *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983) (*"MFJ"*). These operating companies provide exchange telecommunications and exchange access services within fourteen states. All of the outstanding stock in these companies is owned by U S West, Inc., an individual holding company established pursuant to the *MFJ*.

[2] *MTS and WATS Market Structure: Third Report and Order*, 93 FCC 2d 241 (1983) ("Access Order").

[3] *See NARUC v. FCC*, No. 83-1225, slip op. at 109 (D.C. Cir. June 12, 1984).

[4] *MTS and WATS Market Structure: Memorandum Opinion and Order*, 48 Fed. Reg. 42984 (1983) (Reconsideration Order), 49 Fed. Reg. 7810 (1984) (Further Reconsideration Order).

the District of Columbia Circuit found that the Commission's action was "rationally grounded and sufficiently supported by evidence." [5]

One of the principal determinations made by the Commission in its Access Order (and the focus of the instant petition for a writ of certiorari) was that part of the cost of local telephone company plant used in interstate services should be recovered through a system of flat fees assessed against all telephone subscribers. This flat end-user fee (initially denominated the "Customer Access Line Charge" or "CALC") is calculated to recover a portion of the cost of nontraffic-sensitive plant utilized to provide access to the interstate network.[6] Specifically, these interstate costs are a portion of the nontraffic-sensitive costs which must be incurred to connect a customer to both the local network and the long-distance network (*e.g.*, the wire between the customer's premises and the local exchange central office), which are assigned to the jurisdiction of the Commission by a process known as "separations." [7] Because the plant costs themselves

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[5] *NARUC v. FCC*, slip op. at 19. In a brief supporting the NARUC Petition, the Connecticut Department of Public Utility Control argues that there was an insufficient evidentiary basis for the Commission's action. However, once a court of appeals has determined that an agency factual decision is supported by substantial evidence, the case does not merit further review. *NLRB v. Pittsburgh S. S. Co.*, 340 U.S. 498, 502-03 (1951).

[6] *See NARUC v. FCC*, slip op. at 29. NTS costs, in turn, constitute a large part of the cost of the local telephone plant. *Id.* at 19.

[7] Since this Court's decision in *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930) (hereinafter "*Smith*"), the regulatory scheme for cost recovery of local telephone company facilities has provided for an allocation of such recovery between the federal regulator (originally the Interstate Commerce Commission, now the Federal Communications Commission) and the various state regulatory commissions. Under this format, an ascertainment was made of the portion of local telephone company facility costs attributable to the provision of interstate (long-distance) services, and that portion was recoverable through rates set by the federal regulator. The remaining cost recovery was the regulatory responsibility of

are nontraffic-sensitive, they do not vary with usage. For example, the cost of connecting a telephone subscriber's premises with the telephone network is the same whether the telephone is used not at all, infrequently, or non-stop.

While the Access Order did not modify the manner in which a portion of nontraffic-sensitive plant costs was allocated to the interstate (*i.e.*, the Commission's) jurisdiction, it *did* modify the manner in which the costs thus allocated would be recovered from customers. Before issuance of the Access Order, recovery of local plant costs allocated to the interstate jurisdiction was obtained through usage-based charges imposed on the makers of long-distance calls. It is conceded that this system subjected "heavy long-distance users" to payment of a disproportionate part of NTS costs of local facilities.[8] Maintenance of that recovery system also had the potential, according to the Commission's studies and its own expert analysis, of leading to the development of less efficient alternatives through use of "bypass" technologies and the abandonment of the local telephone network by heavy interstate users.[9]

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the various state agencies. Prior to *Smith*, there had been an informal division of long-distance toll revenues between the long-distance supplier (AT&T) and the local telephone company (*e.g.*, Illinois Bell). *See Smith*, 282 U.S. at 143; *Houston v. Southwestern Bell Tel. Co.*, 259 U.S. 318, 322 (1922); *Illinois Bell Tel. Co. v. Moynihan*, 38 F.2d 77, 83 (N.D. Ill.), *rev'd sub nom. Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930).

[8] *See NARUC v. FCC*, slip op. at 22.

[9] *See id.* at 29. In this context, bypass may occur when telecommunications suppliers are forced to price services in an uneconomic manner, thus driving customers to alternative suppliers. For example, traffic-sensitive pricing to recover nontraffic-sensitive costs will have the effect of causing heavy volume customers to seek suppliers whose prices are more reasonably related to the costs incurred in providing service.

In the exercise of its regulatory responsibility, the Commission concluded that a more realistic form of interstate telephone cost recovery was required in order to promote competition and avoid damage to the telephone network. Specifically, the Commission reasoned that all subscribers for use of plant used jointly for interstate and intrastate service should contribute to recovery of nontraffic-sensitive costs incurred on their behalf through payment of an end-user charge.[10] The balance of cost recovery for that portion of local telephone plant assigned to the interstate jurisdiction will continue to be funded, ultimately, from usage-based charges imposed on long-distance carriers and callers.

SUMMARY OF ARGUMENT

Under the doctrine announced in *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930), there must be an allocation of those costs of the local telephone system which are attributable to use of the local exchange for the origination and termination of interstate services, and such costs are to be recovered in accordance with rules established by the federal regulator. This allocation of jurisdiction is reflective of the joint federal-state regulation of the telephone system, under which the federal regulator is responsible for regulation of interstate telecommunications and the various state commissions have regulatory authority over intrastate services. In cases in which the same plant is used for both interstate and intrastate services, *Smith* mandates a jurisdictional (as opposed to a physical) separation in order that both federal and state regulators may properly function in their respective domains.

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[10] Mindful of the impact of this ratemaking change, the Commission provided in its Access Order and in its subsequent reconsideration orders for deferral of imposition of the charge on residential and single-line business users, a maximum charge for such users through the year 1990 and other transitional measures. *See NARUC v. FCC*, slip op. at 31-32.

In its Access Order, the Commission honored the jurisdictional separation mandated by the *Smith* case. The Commission's determination that a portion of local telephone plant costs attributable to interstate services be recovered through a system of charges imposed on subscribers to the joint network was fully consistent with the *Smith* rationale. There is no conflict between the Commission's action and any decision of this Court.

The instant petition raises no other question worthy of this Court's review. Indeed, the record shows that the Commission acted within the scope of its regulatory authority, that its decision is supported by substantial evidence, and that whatever further refinements should be made in this field are best left to the federal regulator. The principal question here is one of regulatory policy, and that is an area traditionally and wisely reserved to the cognizant federal agency.

ARGUMENT

I. THE COMMISSION'S ACTION WAS FULLY CONSONANT WITH *SMITH v. ILLINOIS BELL*

NARUC, relying almost entirely on *Smith*, asserts that the Access Order is illegal and should be reversed. It is NARUC's position that *Smith* mandates that the Commission must direct recovery of nontraffic-sensitive exchange costs assigned to the interstate jurisdiction in a manner which is based upon actual usage of the interstate network (*i.e.*, on a traffic-sensitive basis). Contrary to NARUC's assertion, the essence of *Smith* is jurisdictional separation, not tariff structure. That essence appears clearly from the language of the *Smith* opinion; it is apparent as well in this Court's consistent statements concerning the *Smith* rationale. Simply stated, *Smith* requires that a part of the recovery of local exchange costs be assigned to the jurisdiction of the Commission. *Smith* does not in any way limit or delineate the type of interstate tariff structure which

should govern those rates once they have been validly assigned to the Commission's jurisdiction.

The jurisdictional nature of *Smith* is apparent from other contemporaneous decisions of this Court. For example, it was observed in *Wabash Valley Electric Co. v. Young*, 287 U.S. 488, 497-98 (1933) that under *Smith*:

> where the business of a carrier or utility is both interstate and intrastate, the state rates for intrastate transportation or business must be determined by a separate consideration of the value of the property employed in the intrastate business.

This Court stressed the jurisdictional nature of the separation process announced in *Smith* by noting that separation was required "because a different government exercises the ratemaking power in each of the two fields of regulation . . . ."[11] Likewise, in *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934) (when the *Smith* litigation returned to this Court for the second time), the earlier holding was characterized as follows: "We found that separation was essential to the appropriate recognition of the competent governmental authority in each field of regulation."[12]

Thus, the *Smith* decisional rule is that proper ratemaking methodology requires that the exercise of the ratemaking power be confined to the property, revenues and costs within the jurisdictional authority of the ratemaker. In the telephone/telecommunications field, this translates into a rule that the various state commissions have ratemaking authority over intrastate services and the plant associated with those services, while the Com-

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[11] *Wabash Valley Electric*, 287 U.S. at 498.

[12] *Lindheimer*, 292 U.S. at 155. *See also Lone Star Gas Co. v. Texas*, 304 U.S. 224, 241 (1938) where *Smith* was described as "a case where the segregation of properties and business was essential in order to confine the exercise of state power to its own proper province."

mission has sole ratemaking authority over interstate plant and services.[13] The Access Order does not represent or constitute a breach of that regulatory demarcation. All the Commission has done is devise a method for recovery of the NTS portion of local plant costs assigned to its jurisdiction. While the flat rate method of such recovery is new, it is nevertheless in full compliance with *Smith.*

NARUC, while asserting that the Access Order is inconsistent with the *Smith* rationale, concedes that *Smith*: (i) does not require any particular method of cost recovery;[14] (ii) does not specify that cost recovery be on an usage-sensitive basis; and (iii) does not hold that cost recovery must be from long-distance carriers.[15] NARUC further concedes that *any* method which provides for cost recovery from the interstate jurisdiction is proper under *Smith.* Nonetheless, NARUC argues, inexplicably and without citation of authority, that the Commission has impermissibly transferred all local plant costs to the intrastate jurisdiction, thus creating an alleged conflict with *Smith.*[16]

NARUC premises its argument on two principal points: (i) the asserted existence of two distinct and

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[13] The jurisdictional separation mandated by *Smith* militates against the regulatory whipsawing of public utilities by the two ratemaking jurisdictions. The Court stated it thus in *Smith*: "The [State] Commission would have had no authority to impose intrastate rates, if as such they would be confiscatory, on the theory that the interstate revenue of the Company was too small and could be increased to make good the loss." 282 U.S. at 148-49. *See also New York Telephone Co. v. FCC,* 631 F.2d 1059 (2d Cir. 1980).

[14] Indeed, *Smith* does not deal with this subject at all.

[15] *See* NARUC Petition at 13. In actuality, interstate charges assessed against long-distance carriers are ultimately paid by telephone subscribers, through toll charges and the like.

[16] It is noteworthy that the Connecticut Department of Public Utility Control makes no such contention in its supporting brief.

separable classes of telephone ratepayers, intrastate and interstate; and (ii) the fact that all telephone subscribers must pay the new access charge in order to obtain telephone service.[17] Based upon these two considerations, NARUC asserts that the end-user charges required by the Commission constitute intrastate charges in violation of *Smith*. Both of these premises are ill-founded.

Initially, nowhere in *Smith* can be found any reference to the two distinct classes of telephone ratepayers imagined by NARUC. What the Court dealt with in *Smith* was the existence of two regulatory authorities over telephone service and the need to define and respect the jurisdictional limits of each. In fact, there is only one kind of telephone user, namely the subscriber to the present telephone system, which provides access to intrastate and interstate service jointly through common non-traffic-sensitive plant.[18] There is no basis in fact for the artificial segregation advanced by NARUC, nor does *Smith* anywhere provide a precedential basis for same.

NARUC further argues that *Smith* and Section 410(c) of the Communications Act,[19] allegedly codifying *Smith*, require that the interstate jurisdiction reimburse "the local system for the interstate system's use of its facilities."[20] In effect, however, that is exactly what is accomplished by the Access Order. Subscribers who utilize nontraffic-sensitive plant used to provide interstate service are to pay an access charge which is related to the attributed interstate costs of the local plant. This access

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[17] NARUC claims a constituency of telephone users who neither make nor receive interstate calls. This "class" is not otherwise defined.

[18] Every user of interstate telephone service is a local exchange ratepayer somewhere.

[19] 47 U.S.C. § 410(c) (1982).

[20] NARUC Petition at 15.

charge will be paid to the local telephone companies in reimbursement for interstate use of local facilities. *Smith* is thus followed in both letter and spirit.[21]

There is likewise no merit to the contention that, because the access charge plan requires payment of the interstate cost of the local exchange as a pre-condition to obtaining combined interstate and intrastate service, this somehow transforms the charge into an intrastate rate. This feature no more changes the jurisdictional nature of the charge than do the several state regulatory provisions requiring payment of local charges as a condition for receiving telephone service (which includes interstate services).

The access charge is one determined to be appropriate by the Commission, in the proper exercise of its regulatory authority, and is a charge which is required to be paid before access will be provided to the interstate system through use of exchange plant assigned to the interstate jurisdiction. This manner of payment for the interstate portion of jointly used plant in no way results in an unlawful incursion into the regulatory sphere of the state public utility commissions.

II. THE QUESTIONS RAISED IN THE PETITION ARE NOT OF COMPELLING IMPORTANCE

There being no conflict with the *Smith* requirements, the NARUC petition is devoid of issues meriting the attention of this Court. The argument that the Access Order must be invalidated for the benefit of an undefined class of telephone subscribers "who do not make any use of the interstate system and who, if given the choice, would choose to take intrastate-only access" clearly is

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21 The principal thrust of the supporting brief filed by the Connecticut Department of Public Utility Control is that the access charge will adversely affect "universal service." This is contrary to the *factual* determination of the Commission which, upon review, was found to be supported by substantial evidence.

unworthy of consideration.[22] Putting aside the factual implausibility of this allegation, NARUC does not have the requisite standing to assert this claim,[23] and the claim lacks necessary definiteness and concreteness.[24]

This Court in particular, and the federal judiciary in general, do not sit as super-agencies in review of regulatory methodology. Once it has been established that basic legal requirements have been met and that the regulatory action is statutorily authorized, judicial review is at an end. In the instant case, the Commission determined, after lengthy and extensive deliberation and consideration, to revise the format for recovery of certain interstate costs of the local telephone system. In review, the court of appeals concluded that the action of the Commission was supported by substantial evidence and that the action otherwise was in accordance with law. Further judicial review is neither required nor warranted.

What NARUC is really seeking is that this Court order maintenance of the *status quo* with respect to the manner in which the interstate portion of local plant costs is recovered, notwithstanding the reasoned, expert determination of the Commission that technological and marketplace changes in the telecommunications industry dictated a regulatory change. The net effect of the NARUC position, notwithstanding its protestations to the contrary, is that cost recovery on a usage-sensitive basis is the only permissible method. NARUC's insistence that actual use of the interstate system is a jurisdictional pre-

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[22] NARUC Petition at 18 n.20. NARUC's demand that the Commission "must be required to make available intrastate-only telephone service" (*id.*) is addressed to the wrong party.

[23] *See Larson v. Valente,* 456 U.S. 228, 238-39 (1982); *Valley Forge Christian College v. Americans United for Separation of Church and State, Inc.,* 454 U.S. 464, 471 (1982).

[24] It has been repeatedly emphasized that this Court does not sit "to decide abstract, hypothetical or contingent questions . . . ." *Thorpe v. Housing Authority,* 393 U.S. 268, 284 (1969).

requisite for interstate cost recovery would necessarily limit cost recovery to a usage-basis methodology. The only other alternative would be individual ratemaking and it was found below that such a system of individual ratemaking "would be prohibitively complex and inefficient."[25] Further, the NARUC proposal would result in no net benefit to the consumer since recovery of all line costs would have to come from local rates.[26]

NARUC's attempt to distinguish the court of appeals rulings relied upon below is unavailing. NARUC asserts that those cases involved federal regulation of equipment that was "not feasibly separable for regulatory purposes," while the Access Order dealt with separable costs.[27] However, the cases cited by NARUC[28] dealt with federal preemption of state regulatory authority while, by contrast, in the Access Order the Commission was simply exercising its jurisdiction in the precise area mandated by *Smith.* Moreover, the so-called separable costs perceived by NARUC are for plant and equipment used for interstate *and* intrastate service at one and the same time. These costs are "not feasibly separable" with respect to access to the telephone system, and the rationale of the cases relied upon by the court of appeals is and was fully applicable here.

It is no more impermissible for the Commission to require that all subscribers to telephone service pay their fair share of the interstate cost of providing such serv-

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[25] *See NARUC v. FCC,* slip op. at 43 n.22.

[26] *See id.* at 43.

[27] NARUC Petition at 19.

[28] *See Computer and Communications Industry Ass'n v. FCC,* 693 F.2d 198 (D.C. Cir. 1982), *cert. denied,* 461 U.S. 938 (1983); *North Carolina Utilities Commission v. FCC,* 552 F.2d 1036 (4th Cir.), *cert. denied,* 434 U.S. 874 (1977); *North Carolina Utilities Commission v. FCC,* 537 F.2d 787 (4th Cir.), *cert. denied,* 429 U.S. 1027 (1976).

ice, regardless of use, than it is for the state commissions to assess charges for access to the local system, regardless of use. It is recognized that the solution developed by the Commission may not be a perfect one—but reasonableness, not perfection, is the standard for review.[29] The sensitivity of the Commission to the potential impact of the access charge plan is reflected by its determination to maintain an ongoing review of the effect thereof. The Commission will continue to provide a forum for the expression of concerns regarding the new cost-recovery system. The Commission has acted rationally and responsibly and within its regulatory powers. There is nothing for this Court to review.[30]

CONCLUSION

In the expert view of the Commission, the end-user access charge plan is necessary to assure the integrity and survival of the interstate telephone system. The Commission has concluded, again in the exercise of its expertise, that it is appropriate that *all* subscribers to that system pay a fair portion of the system's costs. The jurisdictional source for the Commission's decision is its unquestioned regulatory authority over interstate telephone services. The Commission's decision is directed to, and acts on, properties and revenues committed to its jurisdiction.

In devising a fair and reasonable structure for recovery of those nontraffic-sensitive costs which have been allocated to the interstate jurisdiction, the Commission properly limited its action in full compliance with the jurisdictional separation mandated by *Smith*. The Commission saw the need for a consistent and coherent national policy concerning the maintenance and enhance-

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[29] *See NARUC v. FCC, supra*, slip op. at 109.

[30] The Connecticut Department of Public Utility Control would have this Court set telecommunications *policy*, a role which this Court has traditionally declined.

ment of the interstate telephone system, and it acted accordingly. The Commission's action was otherwise well within the bounds of reasonableness. Thus, the instant petition raises no issue warranting exercise of this Court's *certiorari* discretion.

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September 19, 1984